Department of the Treasury **Internal Revenue Service** **Office of Chief Counsel**

Notice

CC-2009-023

August 3, 2009

Subject: Federal Rule of Evidence 502 **Cancel Date**: Upon incorporation into the CCDM

Purpose

This Notice provides general guidance relating to the provisions of Federal Rule of Evidence 502. The Federal Rules of Evidence, including Rule 502, are applicable in the district courts and in the Tax Court pursuant to section 7453 and Tax Court Rule 143(a).

Introduction

On September 19, 2008, President Bush signed into law S. 2450, a bill adding new Federal Rule of Evidence 502, which applies in all proceedings commenced after the date of enactment and, insofar as is just and practicable, in all proceedings pending as of the date of enactment. The stated objective for the adoption of Rule 502 is to alleviate some of the costs associated with electronic discovery and document production in litigation by reducing the risks associated with inadvertent production of material protected by the attorney-client privilege or the work product doctrine. If an attorney inadvertently discloses information protected by the attorney-client privilege or work product, the new rule creates a presumption for the return of the inadvertently disclosed information.

Rule 502 limits the circumstances under which inadvertent disclosure of information results in waiver of the attorney-client privilege or work product doctrine and clarifies the scope of subject matter waiver when information is disclosed. The new rule also allows parties to enter into agreements concerning the affect of disclosure in a Federal proceeding and allows a federal court to enter an order finding that, for the purpose of other litigation, disclosure in the proceeding before that court does not result in a waiver. Rule 502 does not change federal or state law on whether information is protected by the attorney-client privilege or work product, rather it modifies the consequences of inadvertent disclosure of documents once it is determined that a privilege exists. Rule 502 also does not relieve an attorney of the obligation to review *potentially* responsive documents to determine whether they are discoverable because they are relevant to the claims and defenses raised or relevant to the subject matter of the action.

Distribute to: X All Personnel
X Electronic Reading Room
Filename: CC-2009-023 File copy in: CC:FM:PF

Background

Changes to Federal Rules of Civil Procedure 16 and 26 in December 2006

Fed. R. Civ. P. 16 and Fed. R. Civ. P. 26 were amended in response to the realization that the Federal Rules of Civil Procedure needed updating to meet the complexities of electronic discovery. Rule 16(b) provides procedures to alert the court to the possible need to address the handling of electronically stored information early in the litigation, including scheduling order agreements that the parties reach to facilitate discovery by minimizing the risk of waiver of privilege or work-product protection. Rule 26(f) directs the parties to discuss discovery of ESI if such discovery is contemplated in the litigation. Rule 26(b)(5)(B) provides a procedure for addressing inadvertent disclosure, specifically giving a party the ability to attempt "claw back" of the information which may have been inadvertently disclosed. The rule though does not address whether waiver has actually occurred.

Fed. R. Civ. P. 16(b) and 26(f) act in tandem to allow the parties who enter into quick peek agreements (when a party agrees to produce information for an initial review) and clawback agreements to ask the court to include these agreements in a scheduling order. Hopson v. Mayor of Baltimore, 232 F.R.D. 228, 232 (D. Md. 2005) (if the parties are able to reach an agreement to adopt protocols for asserting privilege and protection which will facilitate discovery that is faster and at a lower cost, they may ask the court to include such arrangements in an order). The problem with any order trying to preserve privilege or protection under these rules was that a court in a subsequent case could find waiver regardless of the terms of the order. As described in further detail below, these agreements continue to present additional problems even under Rule 502.

Inadvertent Disclosure Concerns

The drafters of new Rule 502 concluded that, under the prior rules, if a party inadvertently produced material there was a risk that a court would find a waiver, not only with respect to material that was inadvertently produced, but also all other material touching upon the same subject. As a result of this risk, lawyers spent significant amounts of time and money in complex litigation reviewing documents and electronic material for production to ensure that nothing protected from disclosure was inadvertently produced. Also of concern was the widespread perception that the costs associated with that type of review had risen dramatically in recent years because of the exponential growth in volume of electronically stored information subject to discovery.

Standards for Waiver pre Rule 502

The standards for waiver of the attorney-client privilege and waiver of the work product doctrine are different. Voluntary disclosure to a third party is inconsistent with maintaining confidentiality and waives the attorney-client privilege. In re Qwest Communications Intern. Inc., 450 F.3d 1179 (10th Cir. 2006); In re Columbia/HCA Healthcare Corp. Billing Practices, 293 F.3d 289 (6th Cir. 2002) (voluntary waiver despite previous confidentiality agreement with the Department of Justice); United States v. Workman, 138 F.3d 1261, 1263 (8th Cir.1998); In re Sealed Case, 116 F.3d 550 (D.C. Cir. 1997); First Heights Bank v. United States, 46 Fed. Cl. 312, 316 (2000).

While the mere showing of a voluntary disclosure to a third person will generally suffice to show waiver of the attorney-client privilege, voluntary disclosure alone might not suffice to waive work product protection. Permian v. United States, 665 F.2d 1214, 1219 (D.C. Cir. 1981). That is,

voluntary disclosure to third parties does not automatically waive work product. In re Sealed Case, 676 F.2d 793, 809 (D.C. Cir. 1982). Waiver of work product protection occurs only when a disclosure enables an adversary to gain access to the information or the disclosure substantially increases the likelihood that an adversary will come into possession of the material. See Westinghouse Elec. Corp. v. Republic of Philippines, 951 F.2d 1414, 1428 (3d Cir. 1991); Ferko v. National Ass'n for Stock Car Auto Racing, Inc., 219 F.R.D. 396, 400-01 (E.D. Tex.2003); In re Convergent Technologies, 122 F.R.D. 555, 564 (N.D. Cal.1988); Anderson v. Torrington Co., 120 F.R.D. 82, 86-87 (N.D. Ind.1987).

Prior to the enactment of Rule 502, there was neither Supreme Court precedent nor consensus among jurisdictions about whether inadvertent disclosure waived the attorney-client privilege. Federal courts generally took one of three different approaches as to whether an inadvertent disclosure of an attorney-client privileged communication constitutes a waiver of the privilege: the lenient approach, the strict approach, or a balancing middle of the road approach. Amgen Inc. v. Hoechst Marion Roussel, Inc., 190 F.R.D. 287, 290-92 (D. Mass. 2000).

Under the lenient approach, the privilege holder must have subjectively intended to waive the privilege. Producing a document through mere negligence cannot effect a waiver. See, e.g., Kansas-Nebraska Nat'l Gas Co. v. Marathon Oil Co., 109 F.R.D. 12, 21 (D. Neb. 1985); Mendenhall v. Barber-Greene Co., 531 F.Supp. 951, 954-55 (N.D. III. 1982). At the opposite end of the spectrum, the strict approach waives the privilege regardless of the privilege holder's intent. See, e.g., In re Sealed Case, 877 F.2d 976, 979-80 (D.C. Cir. 1989). That is, any document produced, whether knowingly or inadvertently, loses its attorney-client privilege status. This approach created incentives for careful document management during discovery. The third approach, the middle test, required courts to consider the circumstances under which the inadvertent production of a privileged document occurred. See, e.g., Alldread v. City of Grenada, 988 F.2d 1425, 1434 (5th Cir. 1993); Hydraflow, Inc. v. Enidine Inc., 145 F.R.D. 626, 637 (W.D.N.Y. 1993). The middle test analyzes whether the client and lawyer took reasonable precautions to prevent disclosure. The courts then balance the client's obligation to safeguard confidential documents against the simple fact that mistakes are made in large-scale litigation and privileged documents are sometimes inadvertently produced. Gray v. Bicknell, 86 F.3d 1472 (8th Cir. 1996). In general, when there has been an inadvertent disclosure, the analysis for waiver of the work product doctrine is similar to the analysis for waiver of attorney-client privilege. Carter v. Gibbs, 909 F.2d 1450 (Fed.Cir.1990).

Courts have found that waiver of the privilege in an attorney-client communication extends to all other communications relating to the same subject matter regardless of whether the disclosure is inadvertent. In re Sealed Case, 877 F.2d at 980-981. Courts differ, however, as to the scope of the subject matter that would be subject to the waiver. For example, certain courts have held that publication of privileged communications on a tax return waives not only the disclosed communication, but the underlying details regarding the subject matter of that communication as well if those details were in some way incorporated in the return. United States v. Cote, 456 F.2d 142 (8th Cir. 1972); United States v. Schlegel, 313 F.Supp.177 (D. Neb. 1970). Other courts have held that the waiver applies to all the underlying information, including drafts prepared and attorney notes. United States v. (Under Seal), 748 F.2d 871 (4th Cir. 1984).

As applied by the courts, the broad concepts and scope of subject matter waiver analogous to those applicable to claims of attorney-client privilege are different from the scope of subject matter waiver for work product. Some courts have found that, while subject matter waiver applies to fact work product, subject matter waiver does not apply to opinion work product. In re Martin Marietta Corp., 856 F.2d 619, 625-626 (4th Cir. 1988). Other courts have found that the concept

of subject matter waiver does not apply at all to work product. Continental Cas. Co. v. Under Armour, Inc., 537 F.Supp.2d 761, 773 (D. Md. 2008) (when work product protection has been waived, it is limited to the information actually disclosed and there is no subject matter waiver); In re United Mine Workers of America Employee Benefit Plans Litig., 159 F.R.D. 307, 310-12 (D.D.C. 1994) (production of documents protected by work product doctrine resulted in waiver of privilege only as to those documents produced).

Fed. R. Evid. 502

Rule 502 covers waivers as a result of voluntary or inadvertent disclosure. It does not purport to deal comprehensively with either attorney-client privilege or work product protection or cover all issues concerning waiver or forfeiture of either. The rule also does not affect other common law waiver doctrines, such as waiver by implication, which occurs when the party asserting the privilege places protected information in issue for personal benefit through some affirmative act, and the court finds that to allow the privilege to protect against disclosure of that information is unfair to the opposing party. In re Keeper of Records, 348 F.3d 16 (1st Cir. 2003).

Rule 502(a)

Rule 502(a) addresses the issue of subject matter waiver when there has been an intentional disclosure made during a federal proceeding or to a Federal office or agency. It applies only to the information disclosed, unless a broader waiver is made necessary by the holder's intentional and misleading use of privileged or protected communications or information. Subsection (a) provides that, when a party produces one privileged document, any resulting waiver of the privilege would not extend to other related documents, so long as there was no intentional and misleading use of protected or privileged information. If a party intentionally places protected information into the litigation in a selective, misleading and unfair manner, then there will be a waiver as to the undisclosed information concerning the same subject matter. Under subsection (a), the waiver extends to an undisclosed communication or information in a Federal or State proceeding only if: (1) the waiver is intentional; (2) the disclosed and undisclosed communications or information concern the same subject matter; and (3) they ought in fairness to be considered together. Subsection (a) clarifies existing law and rejects the position taken by some courts that inadvertent disclosure of protected material can constitute a general subject matter waiver as to other documents or information. This subsection also provides that the federal rule on subject matter waiver governs subsequent state court determinations concerning the scope of the waiver.

Fed. R. Evid. 502 (b)

Rule 502(b) in general codifies the majority rule of the federal courts regarding whether the test to determine if an inadvertent disclosure operates as a waiver of attorney-client privilege or work product. Specifically, the rule provides that disclosure of privileged materials is not a waiver of the privilege if: (1) disclosure is inadvertent; (2) the holder of the privilege or protection took reasonable steps to prevent disclosure; and (3) the holder took reasonable steps to rectify the error, including following Fed. R. Civ. Proc. 26(b)(5)(B) if applicable. Subsection (b) resolves the current split among the courts regarding the consequences of inadvertent disclosure. In general, the rule opts for the middle-of-the-road approach. Subsection (b) literally posits a two-part test that only accounts for the reasonable precautions taken and the promptness of the measures taken to rectify the error. The middle-of-the-road approach adopted by the courts was a multi-part test rather than a two-part one. The Advisory Committee, however, retained other traditional middle-of-the-road factors in its note following the rule, stating that the "rule is flexible enough to accommodate any of those listed factors." The requirement to take reasonable steps to prevent

disclosure mandate an appropriate level of review to determine if information is privileged or protected and, as such, appears contrary to the goal of reducing the costs associated with ESI discovery.

The case of Rhoads Industries, Inc. v. Building Materials Corp. of America, 254 F.R.D. 216 (E.D. Penn. 2008), illustrates relevant factors that a court may look to when determining whether an inadvertent disclosure amounts to a waiver under Rule 502(b).

In Rhoads Industries, a dispute arose between the parties as to whether plaintiff's inadvertent disclosure of over eight hundred electronic documents amounted to a waiver of privilege with respect to those documents. Upon receiving notice of the inadvertent production, defendants segregated the documents, provided them to the court for *in camera* review, and then the parties agreed that the documents could be returned to plaintiff for logging on a privilege log for further review. Defendants claimed that the privilege relating to these documents was waived by the production of them.

The Rhoads Industries court employed a five factor balancing test under Rule 502(b) to determine if the privilege had been waived. The five factors are: (1) the reasonableness of the precautions taken to prevent inadvertent disclosure in view of the extent of the document production; (2) the number of inadvertent disclosures; (3) the extent of the disclosure; (4) any delay and measure taken to rectify the disclosure; and (5) whether the overriding interests of justice would or would not be served by relieving the party of its errors.

The court found that, when weighing the evidence, the first four factors favored the defendants. The most significant factor was that the plaintiff failed to prepare the segregation and review of privileged documents sufficiently far in advance of the inevitable production of a large volume of documents. The court noted that, once the lawsuit seeking millions of dollars in damages was filed, the plaintiff was under an obligation to invest resources in managing potentially responsive documents.

The court also found that the fifth factor, the interest of justice, strongly favored the plaintiff. The court weighed the loss of the attorney-client privilege against the defendants' need for the information, and determined that the defendants would not be prejudiced by the withholding of the privileged information. Therefore, although four out of the five factors were decided in defendants' favor, the court held that the inadvertent disclosures in this case did not amount to a waiver of the attorney-client privilege.

Rule. 502 (c) and (f)

Rule 502(c) and (f) deal with federal-state comity. If there is a disclosure in a state proceeding, then admissibility in any subsequent federal proceeding will be determined by the law that is most protective against waiver. Rule 502 does not, however, apply to any disclosure made in a state proceeding that is later introduced in a subsequent state proceeding. Subsections (c) and (f) may eventually raise Constitutional questions to the extent they overrule the holding of Erie Railroad Co. v. Tomkins, 304 U.S. 64 (1938), by encroaching on substantive privilege law that has traditionally been left to the states.

Rule 502 (d)

Rule 502(d) allows a federal court to enter an order finding that a disclosure of privileged or protected information does not constitute a waiver. That order will be enforceable against

persons in federal or state proceedings and third parties.

Under one possible scenario, the producing party's attorney may choose to intentionally produce an array of documents without reviewing them, knowing with near certainty that they will contain some privileged documents, but relying on the Rule 502(d) order to protect against waiver. Under this scenario, the receiving party would bear the burden of the initial review of the documents by identifying potentially privileged documents and giving notice to the producing party that the produced documents contained privileged or protected information. The receiving party would then decide whether to refrain from reviewing and using the documents.

Rule 502 (e)

Rule 502(e) provides that the parties can enter into an agreement concerning the effect of disclosure in a Federal proceeding, but that agreement will only be binding on the parties to the agreement, unless it is incorporated into a court order pursuant to subsection (d).

Discussion

While Rule 502 is designed to deal with discovery when vast amounts of documents are transmitted and stored electronically, it also applies to those requests seeking only a handful of paper documents. Agreements, such as claw-back agreements (agreements regarding the disposition of inadvertently produced documents) and quick-peek agreements (agreements allowing the requesting party take a quick peek at documents without the producing party undertaking the time and expense in advance to review the entire population of documents), should be avoided.

Generally, under a claw-back agreement, the producing party reviews the documents for privileged or protected information, but the parties agree to a procedure for the return of privileged or protected information that is inadvertently produced. Conversely, when a quick-peek agreement is used, the parties agree that the requesting party will be allowed a pre-production opportunity to inspect the producing party's information, including certain information that may be subject to a claim of privilege. The requesting party then provides the producing party with a request to produce potentially relevant information, which may include the information viewed during the pre-production inspection, and the producing party excises any privileged information from the information determined to be relevant by the requesting party. As a result, the use of quick-peek agreements is inconsistent with the producing party's duty to take reasonable steps to prevent disclosure of privileged or protected information. After the requesting party identifies the documents to be produced, there is still the possibility that a privilege or work product fight will ensue.

There is a concern that these types of agreements will be sought even when documents are not privileged or protected in the first instance. If the information is not privileged or protected, the Service is entitled to receive this information without an agreement. The proper process for obtaining information from the taxpayer is to request the information and then require the taxpayer to prove that it is privileged or protected.

The liberal use of these types of agreements, without first establishing that the documents are privileged or protected, may give taxpayers the impression that they are entitled to these agreements and that the government must negotiate an appropriate agreement before a taxpayer must turn over the responsive documents. Taxpayers may use the negotiation of an agreement as basis for dilatory behavior and simply not turn over responsive information until an agreement

to their satisfaction has been entered into.

Entering into such agreements at the audit stage also presents problems. If a revenue agent enters into such an agreement with a taxpayer, that agreement may be binding on Counsel or the Department of Justice should the matter go to litigation.

Rule 502(e) provides that the parties can enter into an agreement concerning the effect of disclosure in a Federal proceeding, but that agreement will only be binding on the parties to the agreement, unless it is incorporated into a court order pursuant to subsection (d). Any agreement at the audit stage that provides that disclosure does not constitute a waiver would not protect against a waiver claim in subsequent litigation by a third party unless the previous audit resulted in litigation and the court entered an order adopting the agreement between the original parties.

Entering into a non-waiver agreement with a view to adoption by the court might be viewed as the Service taking a partisan position in pending or prospective litigation between private litigants for expediency's sake. For example, it may be argued that the entry of a Rule 502(d) order raises a question of whether that order violates the Due Process rights of persons and entities who are not parties to the Tax Court litigation because the rule purports to make an order of the court binding on all persons and entities in all federal or state proceedings, whether or not they were parties to the litigation and regardless of whether the nonparties are subject to the jurisdiction of the Tax Court.

The Advisory Committee notes provide that the rule is limited to the attorney-client privilege and work product protection. The rule does not apply to any governmental privilege, including the deliberative process privilege. The rule also does not apply to the privilege available under I.R.C. § 7525.

Prior agreements, such as the Agreement with Respect to Disclosure in Compliance with Announcement 2002-2, have become superfluous. Those agreements provided that, if the taxpayer produced certain documents, the Service would not assert a subject matter waiver of the attorney-client privilege or the work product doctrine with respect to other documents addressing the same subject matters as those discussed in the listed documents. Rule 502 (a) renders these agreements moot by providing that, when a party produces a privileged or protected document, any resulting waiver of the privilege would not extend to other related documents, so long as there was no intentional and misleading use of protected or privileged information.

Given the concerns and uncertainties regarding the application of Rule 502, as well as the potential impact on the Service's operations and federal tax litigation, any agreement regarding privilege claims and waivers of privilege or the application of Rule 502 must be pre-approved by the Associate Chief Counsel (Procedure & Administration).

Questions regarding Fed. R. Evid. 502 should be directed to Peter Reilly at 202-622-7071.

_____**/s/**_____
Deborah A. Butler
Associate Chief Counsel
(Procedure & Administration)

Attachment

Fed. R. Evid. 502, entitled Attorney-Client Privilege and Work-Product Doctrine; Limitations on Waiver, reads as follows:

(a) DISCLOSURE MADE IN A FEDERAL PROCEEDING OR TO A FEDERAL OFFICE OR AGENCY; SCOPE OF A WAIVER.—When the disclosure is made in a Federal proceeding or to a Federal office or agency and waives the attorney-client privilege or work-product protection, the waiver extends to an undisclosed communication or information in a Federal or State proceeding only if:

(1) the waiver is intentional;

(2) the disclosed and undisclosed communications or information concern the same subject matter; and

(3) they ought in fairness to be considered together.

(b) INADVERTENT DISCLOSURE.—When made in a Federal proceeding or to a Federal office or agency, the disclosure does not operate as a waiver in a Federal or State proceeding if:

(1) the disclosure is inadvertent;

(2) the holder of the privilege or protection took reasonable steps to prevent disclosure; and

(3) the holder promptly took reasonable steps to rectify the error, including (if applicable) following Federal Rule of Civil Procedure 26(b)(5)(B).

(c) DISCLOSURE MADE IN A STATE PROCEEDING.—When the disclosure is made in a State proceeding and is not the subject of a State-court order concerning waiver, the disclosure does not operate as a waiver in a Federal proceeding if the disclosure:

(1) would not be a waiver under this rule if it had been made in a Federal proceeding; or

(2) is not a waiver under the law of the State where the disclosure occurred.

(d) CONTROLLING EFFECT OF A COURT ORDER.—A Federal court may order that the privilege or protection is not waived by disclosure connected with the litigation pending before the court—in which event the disclosure is also not a waiver in any other Federal or State proceeding.

(e) CONTROLLING EFFECT OF A PARTY AGREEMENT.—An agreement on the effect of disclosure in a Federal proceeding is binding only on the parties to the agreement, unless it is incorporated into a court order.

(f) CONTROLLING EFFECT OF THIS RULE.—Notwithstanding Rules 101 and 1101, this rule applies to State proceedings and to Federal court-annexed and Federal court-mandated arbitration proceedings, in the circumstances set out in the rule. And notwithstanding Rule 501, this rule applies even if State law provides the rule of decision.

(g) DEFINITIONS.—In this rule:

(1) “attorney-client privilege” means the protection that applicable law provides for confidential attorney-client communications; and

(2) “work-product protection” means the protection that applicable law provides for tangible material (or its intangible equivalent) prepared in anticipation of litigation or for trial.